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Close Diversified Income Portfolio Fund

Monthly fund manager update

DECEMBER 2020

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PERFORMANCE

The Close Diversified Income Portfolio Fund rose +0.9% in December and delivered +1.4% in 2020. This was achieved despite the covid-induced economic difficulties and losses experienced by the UK stock market (with UK Large-Caps dropping -14.3% during the year). To give you an idea of the business impact of Covid-19, the top 100 UK companies by market capitalisation had on average a 32% downgrade to their 2020 profit expectations and a 14.6% downgrade to those anticipated in 2021. As I write this commentary on the 4th January the fund is trading at an all-time high Net Asset Value (NAV), so all investors are making positive returns.

In terms of income generation, the diversified nature of the fund meant that this held up well, despite the plethora of companies suspending dividends in the wake of the pandemic. The income was also helped by some recycling of cash and gilts into better yielding ideas in the market sell-off.

AJ Bell's Dividend Dashboard calculates that UK Large-Cap dividend payments will be down 20% for 2020, but adding up the four dividends paid on the fund's X Income share class in 2020 comes to 5.30p, which is only 1.6% down on that achieved in 2019, when the dividends paid were 5.385p.

For 2020 gold and silver were the fund's standout performers (+24.8% and +48.2% respectively). The fund has a 4.6% weighting to these Alternative holdings and despite having no income they have yet again proved themselves a good diversifier, helping to smooth the path of returns for investors. They also continue to be a good hedge against any significant political or central bank policy error that may lead to protracted currency weakness.

Whilst the UK stock market was weak in 2020, international equities were generally positive: Europe was -4.8% in EUR terms but +1.4% in GBP terms. In the US, the S&P 500 wasn+16.3% in USD terms (+13.3% in GBP terms); and the NASDAQ 100 +43.6% in USD terms (+40.6% in GBP).

It is interesting to note a number of press articles talking about a return to the "Roaring 20s", referring to the large stock market gains of the 1920s, but if we look at a long-term chart of the Shiller P/E ratio for the US market for instance, we can see that the 1920s started with a valuation of 5x earnings, and re-rated to 30x by 1929. At the end of 2020 the US Shiller P/E ratio was already at 34.2x, the second most expensive period on record.

Corporate bonds had another positive year (we hold no Gilts after selling them in the covid-induced sell-off to reinvest proceeds into better risk/reward ideas). Over the course of the year, the 10 year gilt yield went from 0.82% to 0.20%, with Gilt maturities out to 2027 now all negative yielding (i.e. you are buying them to lose money if held to maturity). In terms of corporate bond spreads:

- "A" rated spreads finished the year at 0.89% after starting the year at 1.13%
- "BBB" rated spreads finished the year at 1.44% after starting the year at 1.61%
- Junk rated "BB" spreads finished the year at 3.22% after starting the year at 2.82%

Investment grade bonds have not only shrugged off the pandemic, they have become more expensive than at the start of the year and, coupled with the collapse in gilt yields, have become much lower yielding.

PORTFOLIO ACTIVITY

So what did I do in December?

I reduced the Phoenix 2025 bond (a top 10 position) at yields as low as 2.28%. Regular readers of this column may remember that we began buying this in 2016 at a yield of 6.8% and actively bought more as the company struck a deal with Axa, began to deleveraged and therefore de-risk. This holding has given an annual return of 10.5%, though at its current yield there is barely 10.5% of return left to be had over the next five years.

The cash was reinvested into the Phoenix equity at yields as high as 6.7%. Whilst the company's bonds have gotten a lot more expensive over the last five years, on various valuation measures Phoenix equity has actually gotten cheaper (in part due to the poor UK stock market performance), and that is despite management addressing the issue of their business being a shrinking one (they now write new business). The equity's yield has also risen over the period too. This switch looks attractive in risk/reward terms over the coming 5 years.

New positions were started in a Pension Insurance Corp Perpetual bond (callable in 2029) and a Rothesay Life Perpetual bond (callable in 2028) each at a 4.6% yield - though other bonds from these companies are already held so the entities themselves are not new to the fund.

The Paragon 2020 bond successfully matured, and the Travis Perkins 2021 bond was bought back from us by the company at a yield of just 0.4%. The BHP Billiton Perpetual bond (callable in 2022) was further reduced at yields as low as 1.29% (this is one we added to at yields of 6% in the covid sell-off). Top slicing low yielding names barely has any impact on the forward looking yield of the Fund, yet it allows us to reinvest proceeds when better risk/reward ideas present themselves.

Given the high weighting in precious metals, the decision was taken to add a new gold ETC, Royal Mint Physical Gold, which further diversifies our counterparty and vault exposure risk.

YIELD

The fund's yield (based on end of month prices) rose to 3.8% from 3.7% at the end of November. The yield of 3.8% is higher than the 3.4% reported at the end of Dec '19, despite the impact of the pandemic on some of the holdings (in terms of lower, deferred and cancelled dividends). This increase in yield is despite a rising cash position (cash levels increased to 11% from 9.8% on the back of maturing bonds and reducing weightings in other bonds such as BHP Billiton).

This cash, whilst having no yield, still has a better forward looking return than short-dated gilts which used to be out first port of call to invest spare cash. Having cash gives optionality and it will be invested in new ideas as they are identified, or when any market pull back makes valuations in general more attractive.

The fund's yield is the result of all the individually picked attractive risk/reward ideas. In this tough environment, the hard work continues to find attractive risk/reward ideas across the whole spectrum of asset classes in which the fund is able to invest.

OUTLOOK

In December, a Brexit deal of sorts (some details are still missing) was announced which was seen as a positive ahead of the 31st December deadline. Hopes abound that the various vaccines that have been approved will be rolled out to the populous in H1 2021, leading to a return to normality, or a new normality at least. The current reality is, however, that the virus is leading to harsher lockdowns across the world and business leaders are already crying out for government assistance programmes to be extended to help avoid bankruptcies and job losses.

Valuations do not look overly attractive and whilst technology stocks have fared well in the 2020 (The 'Year of Working from Home'), they are coming under increasing scrutiny from the authorities and will face tough comparatives in 2021.

CLOSE DIVERSIFIED INCOME PORTFOLIO FUND PERFORMANCE AS AT 31 DECEMBER 2020

	YTD	2019	2018	2017	2016	2015
Close Diversified Income Portfolio Fund	**1.4%**	**9.8%**	**-1.8%**	**5.4%**	**7.8%**	**2.4%**
IA Mixed Investment 20-60% shares	3.5%	11.8%	-5.1%	7.2%	10.3%	1.2%

SOURCE:

FE Analytics 05.01.2021; YTD data as at 31.12.2020. Performance is total return, net income reinvested after fees, X Acc share class.